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To: Anne Jackson; Deputy Secretary Schools
Lesley Longstone, Chief Executive

Cc: The Novopay Board (Ministry Personnel Only)

From: Leanne Gibson Chief Information Officer

Date: 19 April 2012 **File:**

Subject Recommendations associated with the outcome of the Warning Letter issued to Talent 2 on the 5th April

PURPOSE

The purpose of this memo is to provide recommendations from the Novopay Board to the Business Owner and Chief Executive for consideration regarding the next steps to be undertaken given the SIT milestone has not been achieved as per our Warning Letter dated 5th April.

At this stage, the Ministry still considers the delivery of the Novopay project possible if the proposal presented by T2 on the 18th April is delivered by the 31st May and has a contractual construct associated with it.

BACKGROUND

The Novopay Board requested that a series of Confidence Points be constructed in February and March 2012 as a mechanism for controlling slippage of key deliverables in the Novopay project.

As at Monday 2nd April, two of the four requirements had not been met.

- 1) The contractual Systems Integration Testing (SIT) milestone was not met because the agreed acceptance criteria had not been met (eg, approximately 50 defects had not been fixed and 36 test scripts were still to be run).
- 2) FDS 79 was constructed and partially tested but the acceptance criteria had not been met (eg 10 defects have not been fixed and a number of regression scripts were still to be run).
- 3) The Payroll Verification Comparison Tool was ready.
- 4) Data Conversion activities were confirmed as completed by Talent2 but had yet to be verified formally by the Ministry.

The Ministry chose to issue a warning letter to Talent2 on Thursday 5^h April, indicating that the a notice of material breach would be issued on the 18th April if the following items were not delivered:

- the SIT milestone

- a full cycle of informal End-to-End testing
- all defects/scripts associated with FDS79

We also signalled that non-delivery would be likely to have a spiralling impact on the rest of the re-baselined plan and deliverables, making it extremely unlikely that an August go-live would be feasible.

STATUS

Executives from Talent2 attended the Novopay Board on the 12th April to respond to the Warning letter verbally. They requested assistance from the Ministry to find a “circuit-breaker” mechanism to address the impasse regarding the SIT milestone.

Following extensive analysis of defects and test scripts over the period 14 April – 16 April, both parties have agreed that the SIT Milestone cannot be met by 18 April.

Talent2 put a proposal to the Ministry on the 17th April and then presented and took questions about it from the Novopay subcommittee meeting on the 18th April. The proposal recommended undertaking the following tasks by May 31st:

- running three cycles of end-to-end 32PP
- running a slim end-to-end 3rd party and integration cycle
- Fixing outstanding SIT defects
- Running outstanding SIT test scripts
- running a cycle of end-to-end formal 2-week
- delivering all other requirements associated with meeting Confidence Point 2.

The Ministry has considered its options and these are outlined below:

1. The Board's preferred option is to allow T2 to undertake their proposal with the following caveats
 - a) That the plan is tested & refined with the wider Project team
 - b) That a contractual construct is developed by T2 to go with their proposal by the 24th April and approved by the Ministry.
 - c) That both parties revisit key leadership roles and consider having only one programme manager and project management office moving forward. They have also suggested a more agile approach might be utilised at this time.
 - d) That the ICT Council offer be accepted to undertake a health check of the project in the next few weeks.
2. If T2 will not provide a new contractual construct, the Novopay Board recommends that the Ministry issue a material breach notice on the 26th April requiring Talent2 to remedy the failure to complete the SIT Milestone, within 15 working days of the notice.
 - a. The analysis undertaken last weekend confirmed that T2 continues to make solid progress with the Novopay platform but that they have effectively run out of time to fix the required defects and meet the quality assurance criteria required to move into the next testing phase.
 - b. The Ministry believes it is highly likely that these faults could be remedied within the 15 working days allowed after a material breach

notice, but the Ministry anticipates that in doing so, the End-to-End testing phases are likely to be seriously compromised.

- c. In practical terms, it is highly unlikely (but still possible) that T2 could deliver the SIT milestone and exit both cycles of End-2-End testing and complete all other items required for Confidence Point Two by the 30th May. It would be inadvisable for the Ministry to allow a further time extension of the SIT milestone given it is now 4 months late, and that timely completion of the SIT milestone is an essential pre-requisite for conducting meaningful End-2-End testing and thus obtaining the degree of assurance needed for the Ministry to allow an August go-live.

- d. If Talent2 does not complete the SIT milestone within the 15 working day period, the Ministry will be entitled to give notice to terminate the agreement. If Talent2 does complete the milestone, the project will continue (subject to any separate termination rights for other milestone delays), but the material breach notice would nonetheless count as the first of three "strikes" for Talent2, where two more strikes would entitle the Ministry to give notice to terminate the agreement immediately.

- 3. Another option we considered was to investigate utilizing the best portions of the Talent2 and Datacom business continuity proposal to deliver a Novo-Datapay solution (eg Talent2 service centre, Datacom pay centres, Alasco product, LAAS). Though this sounds promising, both organizations have independently stated that they would not work with each other as business partners. Experience states that unless the Ministry acts as the lead integrator (which is a very hard role) then this solution is highly likely to fail.

- 4. The final option we considered was promoting a joint exit from the project. Talent2 do not wish to have a material breach issued for commercial and reputational reasons. It may be therefore be possible for a deal to be brokered with Talent2 to recoup costs in exchange for the issuing of a joint statement about the complexities encountered. We believe this option would not be palatable to T2 or to the Minister.

RISKS

If issued with a material breach Talent2 will make a public announcement to the Australian Stock exchange (as it is an Australian listed entity with only a minor trading entity in New Zealand). This may result in media interest and speculation. We have prepared a communications strategy in the event that the project attracts media or wider attention.

Talent2's warning letter hints at the litigation strategy that they may employ should a material breach notice be issued.

- The Ministry should recognise what Talent2 is saying in the first three paragraphs of page three of its response. First, Talent2 is invoking the (mutual) good faith obligations of the parties under clause 3.3 of the Agreement. Second, it is explicitly asserting that the Ministry's current contractual stance is

to further the collateral benefit of the Datacom contingency (in essence, alleging that the Ministry is improperly motivated by a belief that the Datacom option is somehow quicker/easier/better, rather than a belief that Talent2 will ultimately fail in a material way to deliver under the contract).

- As such, Talent2 is laying the foundations for an allegation that the Ministry is in breach of its good faith obligation, in performing the contract, to further the best interests of both the Ministry and Talent2. This is a clear signal that Talent2 will (as we have previously discussed) adopt the position that any purported termination by the Ministry would amount to a repudiation of the contract within the meaning of clause 18.2(c) of the Agreement. If correct, that would then entitle Talent2 to itself terminate immediately (if the Ministry did not withdraw its repudiation within 15 business days of written notice) and pursue the Ministry for damages.
- To the contrary, in practice the Ministry's unequivocal approach remains that it will not seek to exit the project unless it loses substantially all confidence that Talent2 can deliver a satisfactory product on the go-live date; the Datacom negotiations are and have always been truly a contingency. Any response to Talent2's letter should make this position absolutely clear.
- Thirdly, Talent2's last sentence of paragraph three on page three alleges that the Ministry's management of the project is hindering Talent2's performance of its obligations. This is also relevant to "good faith" dealings. Further, this probably means Talent2 should give notice under clause 1.4 of Schedule 4A detailing the nature of the issue and the impact it is having. So long as the contract remains on foot, it may be prudent therefore for the Ministry to inquire of Talent2 how its project management is hindering Talent2's performance and what it could do differently. This would not necessarily involve the Ministry admitting it is at fault.

RECOMMENDATIONS

The key recommendations of this memo are to note that though both parties have agreed that the SIT Milestone cannot be met by the date outlined in the Warning Letter, the Ministry still considers the delivery of the Novopay project possible if the proposal presented by T2 on the 18th April is delivered by the 31st May and has a contractual construct associated with it. As business owner, I therefore recommend that the Board:

Note: The options considered by the Novopay Board for addressing the non-delivery of the SIT milestone by T2 as requested in our Warning letter.

Note: The Novopay Board supports the T2 proposal (albeit it with the caveats outlined below).

Approve: T2 to undertake their proposal with the following caveats

- a) That the plan is tested & refined with the wider Project team
- b) That a contractual construct is developed by T2 to go with their proposal by the 24th April and approved by the Ministry.
- c) That both parties revisit key leadership roles and consider having only

one programme manager and project management office moving forward. They have also suggested a more agile approach might be utilised at this time.
d) That the ICT Council offer be accepted to undertake a health check of the project in the next few weeks..

Approved YES/NO

		Signature	Date
Anne Jackson			
Deputy Secretary - Schools			

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